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Issues of Confidentiality and Disclosure in Environmental Auditing

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ISSUES OF CONFIDENTIALITY AND DISCLOSURE IN ENVIRONMENTAL AUDITING

by

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This report presents and analyzes legal issues surrounding the confidentiality of environmental-audit-generated inforamtion. It addresses confidentiality and disclosure issues by examining to what extent audit information, if disclosed, could adversely affect its producer, and legal principles and developing case law which may be useful in securing legitimate confidentiality of audit information.

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INTRODUCTION

A growing number of industrial firms are instituting environmental audits at their facilities. EPA considers such auditing an important corporate management technique to assure corporate officers that their facilities are in compliance with environmental requirements and related corporate policies. The Agency has accordingly sought to act as a catalyst and clearinghouse to encourage more firms to evaluate and implement individualized environmental auditing programs, since private-sector auditing can enhance firms' environmental compliance while supplementing scarce government resources.

Some managers considering whether to conduct environmental audits of their facilities have expressed concern that information generated by these audits, if made public, could be embarrassing or potentially sufficient to trigger inspection or enforcement actions that would not otherwise occur.

This perception, that information developed pursuant to a voluntary audit program may be disclosed, is perhaps the greatest deterrent to wider corporate implementation of environmental auditing. Information developed by an audit can expose a firm and its officers to civil and criminal liability, and is potentially subject to pretrial discovery by an adversary party during litigation. Research and the experience of individuals responsible for ongoing corporate audit programs suggest that this threat of disclosure has neither restricted program effectiveness nor created adverse consequences. Nevertheless, the perception that raw audit data or refined information (in the form of memoranda or reports) may subsequently be used against a corporation or its officers must be addressed.

To put the following analysis in context, it is necessary to re-state two basic auditing premises. First, firms without serious commitment to environmental goals rarely implement an environmental auditing system. In firms with auditing programs top managers seem to have analyzed their situation and concluded that the potential benefits from auditing are greater than the potential costs involved, including any costs from possible information disclosures. This may be true either because the risk of disclosure is low, or because the firm has little to lose even if data is disclosed. Second, the audit is a working, evolving management tool used to analyze and evaluate internal corporate procedures, and should not be regarded as primarily a generator of legal documents designed to function in legal areas. In this sense it is similar to a financial audit, though there are sharp differences as well.

This paper attempts to address the confidentiality/disclosure issue by examining first the specific kinds of information audits are likely to produce; second, whether and to what degree that information could adversely affect its producer if disclosed; and third, legal principles and developing case law which may be useful in securing the legitimate confidentiality of audit information.

Finally, it offers suggestions which, if implemented by firms and agencies, may assuage confidentiality concerns while enhancing the ability of audits to assure better compliance and environmental results.

WHY AUDIT?

Many reasons exist for firms to initiate audit programs. For example, auditing systems can help corporate management: (1) project positive concern about environmental effects and commitment to take steps necessary to correct identified problems, (2) avoid substantial tort liability arising from personal injury, property damage, or "toxic tort" claims; (3) avoid the surprise, disruption, and unplanned costs of sudden enforcement actions; (4) develop better relations with government agencies through the presence of an affirmative program designed to find and correct problems before they become dangers; (5) realize savings through process changes which reduce the amount of raw materials needed or create less pollution to be controlled at the end of the manufacturing process; and (6) avoid civil or criminal liability under the large number of federal and state environmental statutes under which firms now operate, including: the Clean Air Act, 42 U.S.C. §§7401 et seq. (1981), the Federal Water Pollution Control Act Amendments of 1972 as amended in 1977, 33 U.S.C. §§1251 et seq. (1981), the Resource Conservation and Recovery Act, 42 U.S.C. §§6901 et seq. (1981), the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("Superfund"), 42 U.S.C. §§9601 et seq. (1981), and the Toxic Substances Control Act, 15 U.S.C. §§2601 et seq. (1981).[1]

Private-sector environmental auditing systems and their necessary accompaniment, plant-level compliance assurance programs which those systems audit, offer chief executive officers (CEOs) and other corporate stakeholders both more effective environmental management and increased comfort or security that procedures to assure compliance with environmental requirements and corporate policies are not only in place, but are operating as planned.[2]

COMPLIANCE ASSURANCE vs. ENVIRONMENTAL AUDITING

"Compliance assurance" has been defined "as a systematic way of determining, attaining, and maintaining [plant-level] compliance with applicable environmental rules and regulations."[3] The primary objective is to establish procedures designed to produce compliance with local, state and federal environmental statutes. "Environmental auditing" is the evaluation of such compliance assurance activities, designed to assure that these procedures are in place and working, and to produce an organized data base. An auditing system enables firms to identify and correct procedures which lead to noncompliance, and to minimize delays and costs resulting from a regulator's identification of noncompliance. Viewed in this perspective, environmental auditing is a management information system that develops a range of data on a firm's compliance performance.[4] It differs from a compliance assurance program primarily because of its evaluative and corrective capacity.

Exhibit 1 illustrates the different activities and products encompassed by compliance assurance and auditing, respectively.5/ Column 1 samples activities compliance assurance usually covers in the firm's interaction with environmental agencies. In contrast, Column 2 samples activities which appear unique to auditing. Unlike the compliance assurance program, auditing often tends to be (1) general, usually more concerned with proper procedures than individual case results; (2) summarily descriptive, providing explanations of business practices relevant to environmental compliance and hazards; (3) evaluative, in that existing practices or conditions are measured on the auditor's scale of environmental management values; and (4) corrective, since audits will suggest specific practical improvements within the firm's capability and will set deadlines for plant or facility managers' response.

EXHIBIT 1

EXAMPLES OF ACTIVITIES IN COMPLIANCE ASSURANCE AND AUDIT PROGRAMS

Column #1

Compliance Assurance

Effluent characterization
Permits to be obtained
Process descriptions
Plant layouts
Operating manuals
Monitoring reports
Statutory spill or emergency exceedance reports
Equipment purchase orders and performance specifications
Engineering test reports
Sample collection and analysis
Compliance information

Column #2

Environmental Auditing

Summaries of information in column 1
Matrix of facilities and applicable rules and permits
List of current violations
List of potential violations
List of hazards (not regulated)
Description of facility internal management control system
Chart of compliance information flows among staff and managers
List of employees interviewed and auditor conclusions
Discussions with plant managers
Independent samples and test results
List of corrections or improvements:
- to hardware
- to management practices
- to corporate policy
- to maintenance procedures
- timetable for corrections or improvements

Description of risk management: policy and practices for making assessments, choices and trade-offs

Exhibit 1 suggests that an audit, which is more centralized and in some ways more detailed than plant-level compliance assurance activities, will increase the reporting of exceedances[6] and make that data more accessible by aggregating information otherwise difficult to discover because of its form or geographic dispersion among corporate facilities. This is the core realization which seems to cause concern among those exploring environmental auditing as a supplemental management tool.

THE DISCLOSURE/CONFIDENTIALITY ISSUE[7]

Disclosure of audit data first becomes an issue when the firm realizes that beneficial audit information in Exhibit 1, Column 2, also may be beneficial to:

- Government regulators who are revising rules, collecting data for regulatory impact analyses, or allocating enforcement resources.
- Government attorneys who are investigating or prosecuting administrative, civil, or criminal cases.
- Competitors whose production strategies, cost structure, and advertising may be influenced by an accurate assessment of competitors' strengths and weaknesses.
- Acquisition target companies who can defend against take-overs by illustrating the acquirer's environmental misdeeds.
- Acquiring companies who might modify or withdraw an offer if the target's environmental liabilities are too great.
- Private plaintiffs who have filed or are considering lawsuits for personal injury, property, or environmental damages from company products or operations.
- Citizen-suit plaintiffs who may seek to enforce compliance with agency rules when an agency has not done so.

The existence of audit information can also enlarge the general duty of corporate disclosure, especially with respect to:

- The SEC, which requires issuers of corporate securities to disclose substantial changes in the projected costs of environmental compliance and liability.
- Stockholders, who may sue for damages or injunctive relief if the firm has disclosed incorrect or inadequate estimates of corporate environmental liabilities.

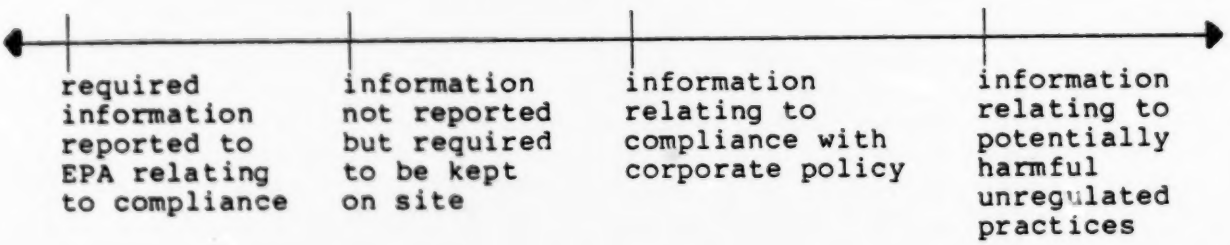
In short, a corporate manager aware of his competitive and legal environment will wonder whether an environmental audit may not simply be a handy way to package valuable business information for use by potential antagonists. Such potential effects produce uncertainty in the manager's decision whether to perform an audit. Methods to control this uncertainty and reduce the probability of information losses exist and are explored below. The important point is that while audit data, like other business information, could be a liability in the hands of an adverse party, the loss is suffered only if the information is actually disclosed. Similar risks have not deterred collection of other data on production, raw materials purchases, or quality assurance believed essential to effective management. The existence of sensitive or confidential environmental audit results need not outweigh the benefits of an audit, if the probability that confidence will be breached is low.

VALUE OF AUDIT INFORMATION

The type of information developed by an audit depends on the particular functions that audit is designed to serve, and will vary depending on whether the primary goal is regulatory compliance, avoidance of tort liability, detection of significant hazards, or cost minimization.[8/] The information contained in the audit report will reflect these corporate objectives. Exhibit 2 reduces such information to categories which reflect different general areas to which audit data can relate. (The categories themselves are important only as points of reference.)

EXHIBIT 2

INFORMATION CONTINUUM


required information reported to EPA relating to compliance
information not reported but required to be kept on site
information relating to compliance with corporate policy
information relating to potentially harmful unregulated practices

Audit information to the left of Exhibit 2 has only marginal additional value to competitors or regulators, since most of this information is already required by EPA and available to the public. "Disclosure" of such information is unlikely to cause a firm significant incremental problems. Indeed, to the extent a firm can show it is making good faith efforts toward correcting discovered problems (most likely in the form of exceedances), the likelihood of adverse publicity, government enforcement actions, or potential penalties may decrease.[9/] Reducing these adverse effects accrues benefits to firms.

Audit information to the left of Exhibit 2 also has other benefits which appear to outweigh potential costs, even if the audit report cannot be kept confidential. What plant managers and CEOs do not know can hurt them, since pollution exceedances which are inadvertent or not brought to management's attention can produce severe negative effects in terms of civil or criminal penalties as well as common law tort actions. Environmental audits can provide the information necessary for remedial action in advance of harm, and can avoid punitive damages, criminal liability, and heavy penalties even where harm is not entirely averted.

Audit information that tends toward the right of Exhibit 2 raises more justified concerns about potential disclosure. For example, where the audit record suggests a firm could have done better but chose not to, a court or jury may be more sympathetic to an individual plaintiff, rendering the firm liable for larger compensatory or punitive damages. More importantly, the information may help a plaintiff prove that specific injuries resulted from a "willful" or "knowing"[10/] instance of noncompliance. This may increase a firm's or officer's culpability from civil to criminal liability. Such "right-side" information crystallizes core disclosure issues. Those issues and possible responses are addressed below.

DISCLOSURE OF AUDIT INFORMATION

Disclosure of audit information which may cause incremental harm -- beyond that posed by required disclosure of compliance data under current statutes and regulations -- must be treated as two separate topics, depending on whether the information is sought by (a) a government agency, or (b) a third party or citizen plaintiff in pretrial discovery.

Information Sought by a Government Agency. Corporate managers fear that despite auditing's ability to improve compliance, audit information, once generated, might be used by EPA or a state agency to subject the firm to more frequent inspection and/or greater enforcement. This could result because an audit tends to aggregate dispersed information ordinarily difficult for EPA or the state to obtain; or because audit information in summary form highlights exceedances; because compliance data can be checked more frequently or thoroughly than through physical inspections. Providing summary information raises fears that if an agency needs "enforcement success stories" audit results will be a handy guide pointing to facilities where pollution problems exist.

It is important to note that this concern assumes the existence of some form of program in which EPA or a state agency formally "takes into account" the presence of a firm's auditing program in exchange for periodic reports showing, for example, that regulatory requirements are being met and exceedances are declining over time.[11/] Neither EPA nor any state has approved or sought to implement

such a program.12/ If such a program were to be implemented, confidentiality concerns might still be balanced against the need for information sufficient to assure that the agency is not simply closing its eyes to potential problems by not requiring any audit information to be submitted. Under this approach firms could be required to keep records on site and file only certain required statements (e.g., notices of exceedances). Information in the audit report would not be held in the Agency and would therefore not be subject to Freedom of Information Act (FOIA) requests.13/ Unless carefully structured, however, this approach might undermine one of auditing's major potential benefits to government -- conserved resources -- by requiring continued physical site visits to participating facilities.

Assuming data is submitted to EPA or a state a second more substantial problem arises. Business competitors, environmental groups, or individuals may attempt to gain access to it under the Freedom of Information Act14/ or state analogues.15/ The Act generally allows members of the public to request and receive information held by an agency of the Federal government. However, nine areas of information are specifically exempt from disclosure under the Act, including information held by an agency which consists of "trade secrets and commercial or financial information obtained from a person and privileged or confidential."16/ The Clean Air Act (42 U.S.C. §7607 (Supp. V 1981)) and other major environmental statutes specifically state that emissions or effluent data may not be treated as confidential. But the general law relating to this FOIA exemption suggests there is substantial room for managers to protect the legitimate confidentiality of aspects of audit information, without compromising either the effectiveness of the audit or such statutory concerns.

The terms "trade secret" and "confidential business" information must be defined. One common definition states that "any formula, pattern, device, or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors" who do not have knowledge of it is a trade secret and therefore confidential.17/ Courts consider several factors when deciding whether information is confidential business information, including whether the information was generated by the firm seeking protection, how well the information is known outside the firm, the value or potential value of the information to the firm, the amount of effort taken to protect the information, and the firm's demonstrated reasonable expectation of confidentiality.18/

The environmental auditing process can help a firm determine whether certain information is a trade secret and then help protect it. A manager with knowledge of what constitutes a trade secret can tailor audit procedures to bolster a firm's claim and increase the chances for nondisclosure. If a corporate officer believes that confidential business information is contained in audit documents available to EPA or a state agency, legitimate measures can not only

be taken to prevent its subsequent release pursuant to a FOIA request, but may be incorporated into audit procedures to routinize this protection.

EPA's disclosure policy states that EPA will disclose records to the public only where disclosure is consistent "with the rights of individuals to privacy" and with "the rights of persons in business information entitled to confidential treatment." 40 C.F.R. 2.101 (1981). 40 C.F.R. §2.201 et seq. (1981) establishes the procedure a firm should follow to assert a claim of confidentiality. A cover sheet stamped "trade secret" or "confidential information" will alert the Agency to the firm's belief that information in the report is confidential and should not be disclosed. Information submitted under such a claim will be held in confidence by EPA unless, after full review of the information and supporting documents, EPA determines the information is not in fact confidential or a trade secret. Information held by EPA which might be expected to contain trade secrets will not be disclosed until EPA determines whether the business is asserting a confidentiality claim. Moreover, willful, unauthorized disclosure of trade secrets or confidential business information by a United States officer or employee is a punishable offense.19/

Clear indications that a document is believed to contain confidential information or trade secrets can create a powerful presumption that disclosure is willful and unauthorized, giving firms deciding whether to undertake an audit a bit more certainty that privileged information will not purposely or inadvertently be disclosed by EPA employees.

Disclosure In Government Enforcement Proceedings. Subject only to minimal statutory requirements, EPA can force firms to submit a broad array of information relating to environmental performance. Environmental statutes authorize EPA to require firms to install and maintain monitoring equipment, keep records on file at facilities, and report to EPA under specified circumstances -- such as when the Administrator determines such information is necessary for developing new standards or regulations or that such information will assist enforcement efforts.20/

Despite these provisions, firms would not be completely vulnerable if EPA decided to request the production of audit information.21/ The Federal Rules of Civil Procedure apply when the government seeks disclosure of information or production of documents pursuant to, for example, a subpoena in Federal district court.22/ Rule 81(a)(3) defines the relevant scope of application of the Federal Rules.23/ Since the Federal Rules govern discovery, including the procedural rules in enforcement actions, the Rules' defenses available to a party attempting to avoid disclosure against a private party are likewise available against the government.24/ These defenses are called "privileges" and are discussed in detail in the following section.

A distinction should be made here between an administrative proceeding itself (e.g., an administrative request for audit information) and the court action to enforce such an administrative request, since the Federal Rules apply only to the latter.25/ In other words, the privileges discussed in the following section may only be raised in a court action brought by the government to compel disclosure after initial refusal by a party to disclose the information pursuant to an administrative request.26/

Because no disclosure issue arises where disclosure of internal audit documents is not sought, an EPA policy statement defining how the Agency would approach the confidentiality issue may effectively establish the limits of disclosure where the Agency is involved, potentially resolving this perceived disincentive to auditing. But even without such a policy statement firms can invoke the same privileges against the government in administrative enforcement actions for the production of audit documents, as against a third party.

Disclosure Relating to Third Parties. The following discussion addresses third-party attempts to compel disclosure of audit information and how a firm wishing to preserve the confidentiality of that information may do so. The analysis is not affected by citizen suit provisions in either the Clean Air (§304) or the Clean Water (§505) Acts since citizen access to Federal courts is coextensive with -- but no greater than -- the Administrator's enforcement authority.27/

The three privileges a corporate defendant may alternatively or conjunctively assert to avoid release of audit information in these circumstances are (1) the attorney-client privilege, (2) the work product rule, and (3) a developing doctrine known as the self-evaluative privilege. Each of these is discussed and illustrated below.

Some general points concerning judicial views of such privileges should first be highlighted. First, a firm asserting a privilege based on confidentiality should realize there is a tendency for courts to scrutinize such claims closely in light of the belief that full disclosure of relevant evidence will aid the process of reaching a just result. Privileges "are not lightly created nor expansively construed, for they are in derogation of the search for truth."28/

Second, however, there is a clear countervailing interest in assuring legitimate confidentiality. The very concept of privilege implies that certain information must remain confidential and certain communications must remain immune from disclosure. Courts recognize the strong public policy that confidentiality is essential in areas where frank discussion serves the larger public interest. This effort to balance the public's need for full disclosure against the public interest in confidentiality underlies judicial determinations of the merits of particular privilege claims.

Third, the mere fact that parties to a communication believe it confidential does not automatically make it so in a legal sense, since that result would allow the privilege to swallow the rule. The court, after moderate scrutiny, will make the final determination. Fourth, certain judge-made doctrines may foreclose attempts to prevent disclosure of otherwise privileged materials. For example, where communications to an attorney or materials which are part of an attorney's work product include information about future criminal conduct or are part of a conspiratorial cover-up, the legal protections against disclosure will be held not to apply in order to prevent subversions of justice or the judicial process.29/

Attorney-Client Privilege. This privilege guarantees the confidentiality of a client's communications to his attorney so the attorney may render competent legal advice. The rationale for the privilege is the assumption that it is less dangerous to incur an occasional miscarriage of justice than to restrict a person's liberty to fully obtain legal advice. Candid communication between a client and his attorney would be stifled if others could discover the substance of their communications. Free flow of information allows the attorney properly to assess his client's needs and render his best advice. This attorney-client privilege is applicable to corporations as well as individuals.30/

The leading case in the attorney-corporate client area is Upjohn Co. v. United States, 449 U.S. 383 (1981), which recently modified the law in federal courts in this area. However, individual states may still apply either of the two traditional rules discussed below and a company should determine which rule applies in its jurisdiction.

Prior to Upjohn, two distinct rules were applied by different courts. One group of courts applied the "control group" test and held that communications to an attorney made by individuals part of the "control group" of a corporation were covered by the privilege.31/ Determination of whether the communicator was in the "control group" involved consideration of his authority to control a decision and relative authority to prescribe or dictate corporate action based on the attorney's advice. This test usually exempted only communications made by senior company employees. A second group of courts applied the four-part "subject matter test" and held that an employee's communication to counsel was privileged if it was (a) at a superior's direction, (b) for the purpose of getting legal advice, (c) related to subject matter in line with the scope of the employee's duty, and (d) not disseminated beyond those persons who needed to know its contents.32/

Upjohn rejected both these tests, but the Court refused to state a new rule, declaring that "we decline to lay down a broad rule or series of rules to govern all conceivable future questions in this area."33/ However, while the attorney-corporate-client privilege was left to be decided in the future on a case-by-case basis, the facts of the case are suggestive with respect to auditing concerns.

In Upjohn, attorneys prepared a questionnaire to investigate alleged "questionable payments" by employees in foreign countries. The questionnaire's purpose was to aid corporate attorneys in advising Upjohn on how to handle this potentially adverse situation. The employees (managers) who received the questionnaire were told to treat the investigation as "highly confidential," not to discuss the case, and to return requested information directly to an Upjohn Vice-President acting as General Counsel. Outside counsel also interviewed some of the employees. The IRS attempted to obtain the questionnaire response files, but Upjohn refused to produce them. The Supreme Court agreed with Upjohn, holding the information was privileged and not subject to disclosure.

The Court noted that in the corporate context "it will frequently be employees beyond the control group...who will possess the information needed by the corporation's lawyers."[34/] Rejecting the control group test, the Court stated that "in light of the vast and complicated array of regulatory legislation confronting the modern corporation, corporations, unlike most individuals, constantly go to lawyers to find out how to obey the law."[35/] It therefore suggested that a broader attorney-client privilege might apply to corporations than to individuals, a suggestion which seems to apply to compliance with environmental regulation as well.

To make the best case to prevent disclosure under the attorney-corporate-client privilege, the factors in Upjohn should be recognized and incorporated in developing or revising an individualized audit program. Practical application of the teachings of Upjohn may provide the strongest legal basis against disclosure of audit results. The factors the Court relied on were:

(1) Employees' communications were made to corporate counsel under orders of their superiors who informed them that the purpose was to secure legal advice.

(2) The information sought by corporate counsel was not held by upper-level management, but held by or known to lower-level employees.

(3) Information conveyed by the managers was within their scope of duties as corporate employees.

(4) Upjohn carefully prepared the questionnaire to make sure employees were aware that the information would be used by counsel to render legal advice.

(5) Upjohn ordered its employees to keep discussions and questionnaires confidential, and in fact they were not disclosed.

These factors seem directly applicable to environmental auditing disclosure issues. Provided a company takes similar precautions, the probability that sensitive information in an audit report will be disclosed should be significantly reduced.

Some general suggestions may help narrow and reduce potential concerns. However, managers should be aware that overly vigorous implementation of these suggestions may also reduce the effectiveness of environmental audits. In general, the points below indicate that (a) the more a firm does to protect its own privacy (within reasonable limits and expectations) the more persuasive its privilege claim is likely to be, and that (b) a reasonable program can be designed and implemented without substantial burdens on company auditors or corporate counsel.

- The audit program should be coordinated by a firm's Corporate Counsel or at least contain procedures to route potentially significant problems to Counsel's office.

- Requests for information from employees should clearly state that such information is required by counsel to render legal advice on environmental compliance or potential liabilities arising from corporate activities.

- The firm should make clear that information necessary to develop an audit report is known only by middle- or lower-level employees.

- A corporation's auditing manual or environmental policy statement is a good place to begin incorporating these safeguards and state both their purpose and the firm's interest in confidentiality of results.

- The manual or policy statement should clearly explain the purpose of the audit (to provide counsel with information upon which advice may be rendered) and establish procedures to include counsel in necessary audit phases, without disrupting the way existing audits are scheduled, conducted and reported.

- Job descriptions should be written to make it part of an employee's duty to assist corporate counsel in environmental compliance.

- Personnel on the audit team and employees interviewed during the audit should be instructed to keep findings confidential and to report them only to the audit team or to counsel.

- A company might minimize the number of written documents by instituting some form of quantity control and by having some findings reported orally. (However, reducing the amount of hard copy may reduce the audit's effectiveness.)

- As evidence of a firm's intent to keep the audit material from being disclosed papers can be stamped "CONFIDENTIAL" or "DO NOT DISCLOSE" and a statement of confidentiality should be added to cover pages or reports. The importance

of attention to detail cannot be overstated. It is essential that correct procedures are established and closely adhered to.[36]

- Once the process is understood and operating the additional burden to auditors or corporate counsel should not be significant.[37]

Finally, it should be remembered that the privilege applies only to communications between employees and counsel. Underlying facts are not immune to disclosure if they are otherwise discoverable. Thus, merely using an attorney as a funnel through which to pass information may not prevent disclosure of facts pointing toward environmental problems or a firm's knowledge of them.

Work Product Rule. The attorney-client privilege protects confidential communications between a client and an attorney so the attorney can render competent legal advice. The work product rule also protects the relationship between attorneys and clients. Rather than protecting communications, however, the rule provides an attorney with a "zone of privacy" in which to think, opine, plan, and evaluate a client's case when litigation looms on the horizon.

The rule accords information or materials assembled in anticipation of litigation or in preparation for trial a qualified privilege from disclosure to an opposing party. Work product is protected because of the inherent unfairness in allowing one party to discover or piggyback on an opponent's litigation strategy. Without this rule one party to a law suit could sit back, allow his adversary to research and thoroughly develop the case, then compel complete disclosure of everything the adversary had learned. Succinctly stated, fear of disclosure of one's work product "would severely affect the performance of the lawyer's role" and encourage shady practices.[38]

The rule was initially formulated by the Supreme Court in Hickman v. Taylor, 329 U.S. 495 (1947). That case summarized the rationale for the rule into four points, a necessary starting place for any work product discussion:

(1) Factual information and witnesses' statements obtained by an attorney are not protected by the attorney-client privilege;

(2) A broad policy against disclosure of information in a lawyer's files does not make these files absolutely immune from discovery;

(3) However, the party seeking disclosure must show special circumstances in order to obtain the information; and

(4) If information desired may be obtained elsewhere, the attorney's work product is not discoverable.[39]

The rule of Hickman has essentially been codified in the Federal Rules of Civil Procedure.[40] Rule 26(b)(3) of the Federal Rules defines the class of materials to be protected ("documents and tangible things...prepared in anticipation of litigation or for trial by or for another party"). It sets out the showing the party seeking discovery must make (a "substantial need and undue hardship" in obtaining equivalent information through other means). It protects an attorney's "mental impressions, conclusions, opinions, or legal theories." It also creates a procedure by which a third party who has given a statement concerning the action may obtain a copy of his own statement.

When a party asserts the work product rule in refusing a disclosure request, courts will consider three factors in deciding the claim: whether the information or materials (1) were collected or prepared in anticipation of litigation or for trial, (2) are documents and tangible things, and (3) were prepared by or for another party or by or for the other party's representative. These requirements must be examined individually.

First, "in anticipation of litigation or trial" establishes a temporal limitation for using the work product rule as a shield against disclosure. At one end of the spectrum, most courts agree that materials prepared in the "ordinary course of business" fall outside the work product rule.[41] It is less clear at what point, prior to actual litigation, the information or materials will be considered as having been developed "in anticipation of litigation." Some cases conclude that reports neither requested by nor prepared for an attorney "nor which otherwise reflects the employment of an attorney's legal expertise" cannot be in anticipation of litigation.[42] However, many cases find information gathered by representatives investigating accidents which occurred significantly prior to any litigation, to be collected in anticipation of litigation. For example, where information was collected by an investigator after the injury of a railroad employee the court held "the expectation of litigation in such circumstances is a reasonable assumption"[43] and protected the information under the work product rule.

Perhaps the best test of this first element is to ask whether the document or information "can fairly be said to have been prepared or obtained because of the prospect of litigation."[44]

The second consideration is whether the materials are "documents and tangible things."[45] The crucial distinction courts make here is between facts and opinion. Facts known to a party's lawyer are not protected by the work product rule. For example, discovery of potential witnesses or information on the existence or nonexistence of documents cannot be prevented. The Supreme Court has stated that "where relevant and nonprivileged facts remain hidden in an attorney's file and where production of those facts is essential to the preparation of one's case, discovery may be properly had."[46]

However, information or materials which are the "mental impressions, conclusions, opinions or legal theories of an attorney"[47] are called "opinion work product"[48] and entitled to greater protection than mere factual information under the work product rule. Whether such opinion work product is entitled to absolute (rather than merely a qualified) protection -- and hence given extra weight when balanced against the general public interest in disclosure -- is still an open question. It has been held that memoranda based on an attorney's interviews "are so much a product of the lawyer's thinking and so little probative of the witness' actual words" that such material is absolutely protected.[49] But most courts do not appear to give opinion work product such absolute protection against disclosure. Opinion work product is more often held to be entitled to "heightened protection."[50] When a document contains facts as well as opinion work product, a court may order disclosure of the facts while protecting the opinion.[51]

Third, Rule 26(b)(3) requires the materials to be prepared "by or for another party or by or for that other party's representative (including his attorney, consultant, surety, indemnitor, insurer or agent)."[52] This allows information developed by parties, or someone acting on their behalf, to be protected from discovery,[53] and broadens the Rule's protection by allowing parties to use agents to conduct interviews.[54]

In the environmental auditing context, much data, reports and information collected from an audit would probably be facts which are not immune from disclosure under the work product rule if the party seeking discovery shows that it has "substantial need" for the data and is "unable without undue hardship to obtain the substantial equivalent" by other means.[55] This is not to say that all information in an audit report would necessarily be available to litigants, since opinions or mental impressions of an attorney (e.g., in interpreting a regulation to determine whether an exceedance or violation exists) would be unlikely to be ordered disclosed. Separation of material in audit reports into "fact" and "interpretation" or "conclusion" sections may help protect the latter categories.

One additional point should be noted by firms potentially relying on the work product rule to prevent disclosure. The qualified immunity provided by the rule may be waived by conduct. Since the purpose of the rule is to prevent disclosure of knowledge to opposing counsel, disclosure to certain third persons (i.e., without regard for the confidential nature of the information) will constitute such a waiver. Of course, disclosure to certain others (i.e., an attorney's support staff) will not act as a waiver of protections afforded by the work product rule. Courts have held this to be the case unless disclosure substantially increases the opportunity for adversaries to obtain the information.[56] In the corporate context, once a decision is made to disclose information otherwise protected by the work product rule, the immunity may be lost. This is true "no matter what the economic imperatives" because confidentiality is inconsistent with such disclosure.[57]

This discussion of work product protections emphasizes its relatively narrow application to auditing. The rule gives firms only a qualified immunity from disclosure of facts contained in materials produced by auditing if they are requested by an opponent during the discovery phase of litigation. Opinions contained in an audit report are somewhat safer from involuntary disclosure, and attorneys' legal opinions even more so. But, in general the rule will not be as powerful a shield against disclosure as the attorney-client privilege. In particular, it may not protect materials developed pursuant to an EA program that has been ongoing for years, because to the extent EA is considered a good management practice it may be found part of regular business activity. Therefore, information and materials routinely generated by the audit might not be considered developed "in anticipation of litigation."[58/] While arguments may be made that an entire audit program is per se in anticipation of litigation -- as railroads or other "target defendants" have argued with respect to routine accident prevention and investigation programs -- it is not clear they would prevail.

Nevertheless, an assertion that audit material is work product may be very effective in certain situations. One such instance might be where a firm is concerned that its operations are causing effects likely to result in a lawsuit by citizens or the government. This may arise where preliminary inspection indicates a firm may be violating applicable standards or where initial epidemiological studies suggest that local health problems may be related to plant operations. If a firm responds by instituting an EA program in order to better understand its potential liabilities in anticipation of future litigation, a claim based on the work product rule would appear valid and sustainable in court. In such a situation, as with the attorney-client privilege, it would be prudent to involve an attorney or "other representative" of the firm as listed in Rule 26(b)(3) in the collection and review of data and information likely to be used in the anticipated litigation.

The Self-Evaluation Privilege.[59/] This evolving privilege appears applicable to environmental auditing and could potentially provide audit information the broadest, most rational and least disruptive protection against disclosure. To date, it has generally been used by courts to protect documents in three regulatory areas: hospital committee meeting minutes, internal disciplinary investigation reports, and equal employment opportunity compliance cases. In addition, at least two states have enacted self-evaluation privilege legislation.[60/] Like other privileges it balances the public need for full disclosure necessary to discover the truth, against the public interest in confidentiality to promote candid communication. Unlike the others, it is specifically aimed at encouraging regulated entities to evaluate their compliance with regulatory requirements and correct problems internally, without fear that looking for problems and their remedies will produce more problems than are found and resolved.

A 1970 federal district court decision in Bredice v. Doctors Hospital, Inc.[61] first established the self-evaluative privilege. The case involved a malpractice suit in which the plaintiff sought production and inspection of certain documents consisting of minutes and reports recording medical staff reviews of patient treatment protocols. These reviews (essentially periodic staff meetings) were established to improve patient care and were conducted with the understanding that all communications during the meeting were confidential. Sustaining the hospital's refusal to produce the documents, the court noted that "confidentiality is essential to the effective functioning of these staff meetings; and these meetings are essential to the continued improvement in the care and treatment of patients".[62] It stated that without confidentiality constructive self-criticism would not occur, and that such criticism would promote public health interests.

Similar self-evaluation privilege claims have since been sustained by other courts when three general criteria are met. First, the information to be protected must result from a self-evaluation. Second, there must be a strong public interest in maintaining the free flow of the self-evaluative information. Third, there must be a finding that the information and procedures used to procure it would necessarily be curtailed if the privilege did not attach.[63]

It can plausibly be asserted that the privilege should extend to environmental auditing, which possesses a similar evaluative nature and ability to serve the public interest in the form of better compliance and a cleaner, healthier environment. In many cases where disclosure of audit information may be at issue the party resisting disclosure would seem to meet the enunciated criteria. First, the information is obviously the result of a self-evaluation, defined as "the evaluation of a firm's compliance assurance activities." Second, the public's strong interest in maintaining the free flow of audit information can be characterized or documented in several reinforcing ways: better compliance with environmental regulations (especially operating/maintenance practices which are difficult for an agency to police through conventional inspections), reduced cost of government monitoring and enforcement, and a proactive effort to identify and correct problems (or potential problems) before they become serious. Third, the view seems widely held that without some method of ensuring the confidentiality of auditing information a large number of firms will resist implementation of auditing programs, despite documented business benefits. In other words, the evaluative information and corrective action produced by auditing will not be generated unless the disclosure risk is reduced.

Whether a firm asserting the privilege could actually meet the burden of proof required by the third criterion (that the production of audit information would be curtailed absent the self-evaluative privilege) seems to be the most difficult question. However, EPA or a state agency could mitigate this problem. EPA could, based on

documented findings that use of auditing would be curtailed if the disclosure issue is not resolved, issue a policy statement finding that auditing is a self-evaluation, and that there is strong public interest in auditing as an environmental policy initiative. Such a policy statement might strengthen firms' ability to prevent unwarranted or counter-productive disclosure, while furthering environmental goals. Without such a statement corporate assertion that the self-evaluative privilege should extend to environmental auditing may not prevail. However, that risk exists only because there is not yet a direct precedent, not because the principles do not apply.

Some additional caveats should be mentioned. First, it appears that like work product, the privilege extends to evaluative but not factual information.64/ Second, the privilege is not absolute and courts have shown their intention that it develop on a case-by-case basis. Third, the privilege can be lost even after a firm has shown circumstances adequate to sustain it. This may occur upon a plaintiff's showing of extraordinary circumstances or exceptional need for the information, though such showings must be powerful indeed.65/

Finally, since the argument for the privilege essentially rests on the public interest served by promoting frank discussion during a self-evaluation, another rule of evidence based on a similar premise may bolster arguments for nondisclosure. The "subsequent remedial measures" exclusionary rule prevents a party at trial from presenting evidence of remedial or precautionary measures taken after the occurrence of an accident or event, where those measures, if taken previously, would have made the accident less likely to occur.66/ For example, on the issue of negligence, evidence showing the defendant's actions in replacing allegedly defective equipment is routinely excluded in order to encourage remedial measures that prevent future accidents and make society a generally safer place. The "subsequent remedial measures" exclusionary rule and the self-evaluative privilege are based on the same policy rationale -- encouraging people to take positive steps now in order to prevent future harm. These converging lines of authority may be used together to assert that audit information should not be disclosed.

CONCLUSIONS

Concern about potential corporate adversaries obtaining audit information appears to have become an obsession in some quarters of the private sector. As this paper demonstrates, much of this concern misses the mark. Much of the information an audit report generates is presently within the government's statutory authority to require reported. A significant part of such information may already be available to potential corporate antagonists, regardless of the presence or absence of an audit program. The relatively small amount of audit generated information that would not otherwise be produced, reported to the government, or discoverable in litigation can largely be protected by an audit system paying careful

attention to legitimate confidentiality concerns. The attorney-client privilege currently affords the best legal defense against unwarranted disclosure, since corporate counsel can easily coordinate an investigation of discovered problems to advise the company of its potential legal obligations and liabilities. The work product rule may not provide protections as broadly. Unlike the attorney-client privilege, it does not protect underlying facts from discovery, and greater temporal limitations apply.

The self-evaluative privilege may have the greatest potential to protect internal audit data. However, this privilege is still evolving and particualr courts may be reluctant to allow its use. EPA or state agencies could substantially mitigate such reluctance by publicly stating a policy against requiring audit information per se to be discovered or reported in routine regulatory proceedings and could state findings and rationales in support of extending the self-evaluative privilege to environmental compliance regimes.

Industry representatives have noted that it is becoming increasingly difficult for corporate management to close its eyes to problems, whether actual or potential, at the plant level.[67] Deliberate or structured ignorance occurs more and more at managers' professional and personal peril. Auditing can help reduce these dangers by instituting procedures for managing compliance more effectively and making sure problems are promptly identified and remedied prior to the arrival of a government inspector, a reporter, or third party complaint. A properly structured audit program is able to achieve these benefits without substantial confidentiality concerns.

(END)

FOOTNOTES

1. This list is illustrative rather than exhaustive.

2. Center for Environmental Assurance, Arthur D. Little, Inc., "Benefits to Industry of Environmental Auditing." Report to U.S. Environmental Protection Agency (1983).

3. "The Evolution of Environmental Auditing: Implications for Firms and for Regulators," by John Palmisano, presented at the Air Pollution Control Association Annual Meeting, Atlanta, Georgia, pp. 3 (June 1983).

4. Id.

5. The following discussion and exhibit were developed in a preliminary memorandum by Richard Ferguson, The Skylonda Group, for U.S. EPA's Regulatory Reform Staff.

6. An exceedance is not a violation. An exceedance indicates a standard is not attained. It becomes a violation upon EPA's filing a notice.

7. The following discussion is partly derived from a preliminary memorandum prepared by Richard Ferguson, The Skylonda Group, for U.S. EPA's Regulatory Reform Staff.

8. Center for Environmental Assurance, Arthur D. Little, Inc., "Benefits to Industry of Environmental Auditing." Report to U.S. Environmental Protection Agency (1983).

9. The preamble of U.S. EPA's Office of Enforcement "Civil Penalty Policy", July 8, 1980, states that the policy "is based primarily on four considerations -- the harm done to the public health or the environment; the economic benefit gained by the violator; the degree of recalcitrance of the violator; and any unusual or extraordinary enforcement costs thrust upon the public. The policy recognizes appropriate mitigating circumstances or factors." Environmental auditing could be a mitigating factor and has been used to reduce potential penalties when included as a requirement in consent decrees.

10. "To act 'knowingly' ... means to act voluntarily and purposefully, and not because of mistake or inadvertence." 22 C.J.S. Criminal Law §31(3)(1961).

11. To the extent an agency informally takes auditing into account by reduced inspection frequency or penalties due to a consistently good compliance record based on prior inspections, no reporting or availability of audit results is implied and the concern does not arise.

12. However, EPA, as part of its general clearinghouse role, is exploring the legal constraints and policy safeguards which would have to be observed in such a program. Michael H. Levin, Chief, Regulatory Reform Staff, U.S. EPA has requested a memorandum on this issue from William F. Pedersen, Jr., Acting Associate Counsel for Air, Noise and Radiation.

13. 40 C.F.R. §2.101 (1983). FOIA only reaches EPA-held documents. Documents not in EPA's possession can not be made the subject of a FOIA request.

14. 5 U.S.C. §552 (1976 and Supp. III 1979).

15. State FOIAs generally contain similar provisions.

16. 5 U.S.C. §552(b)(4) (1976 and Supp. III 1979).

17. Restatement of the Law of Torts §757, Comment (b)(1939).

18. Ridgway Hall, Jr. and David Case, The Environmental Audit, pp. 85 (1982).

19. 18 U.S.C. §1905 (1981).

20. See e.g., Clean Air Act, 42 U.S.C. § 7414 (1981) and the Federal Water Pollution Control Act, as amended, 33 U.S.C. §1318 (1981).

21. However, a constitutional claim based on the Fifth Amendment privilege against self-incrimination would not be likely to succeed. First, at least one leading case disallows a firm's claim that information in a notification of compliance to EPA was improperly used by the government as a basis for its complaint and that the coprporation's rights had been violated. The court responded that the "constitutional argument is patently without merit since a corporation is not entitled to a Fifth Amendment privilege against self-incrimination, California Bankers Assn. v. Shultz, Secretary of the Treasury, et al, 416 U.S. 21 (1974)." United States v. Allied Towing Corp., 12 ERC 1305 (4th Cir. 1978). Second, penalties in environmental statutes are generally recognized as being "civil" rather than "criminal" in nature, and the privilege against self-incrimination applies only to "criminal cases." See, generally, United States v. Ward, 448 U.S. 242 (1980), reh. den. 448 U.S. 916 (1980).

22. Fed. R. Civ. P. 45 discusses subpoena types and rules for enforcement. Subpoenas are used to compel the attendance of witnesses and production of documents so the court may have all available information to determine the controversy before it. Universal Airline, Inc., v. Eastern Airlines, Inc., 188 F.2d 993 (D.C. Cir. 1951).

23. "These rules apply to proceedings to compel the giving of testimony or production of documents in accordance with a subpoena issued by an officer or agency of the United States under any statute of the United States except as otherwise provided by statute or by rules of the district court or by order of the court in the proceedings." Fed. R. Civ. P. 81(a)(3).

24. Much of the case law on this point arises out of Internal Revenue Service (IRS) actions to compel disclosure of financial and tax information. In that context it was stated, "in the absence of a clear negative statutory pronouncement or compelling circumstances... it would seem apparent under...Rule 81(a)(3) that the Federal Rules" apply to the enforcement of IRS summonses. Kennedy v. Ruben, 254 F. Supp. 190, 191 (N.D., Ill. 1966). But see, Fed. Sav. and Loan Ins. Corp. v. National Development Corp., 497 F. Supp. 724 (D.C. Tex. 1980). (While these rules apply in subpoena enforcement proceedings, district courts have discretion in certain circumstances to limit their application.)

25. Falsone v. U.S., 205 F.2d 734 (5th Cir. 1953) cert. den. 346 U.S. 864 (1953) (IRS, through a subpoena duces tecum, tried to compel an accountant to appear and disclose clients' financial information so long as confidential communications were not involved.)

26. However, a privileged communication or relationship which obtains its status only under a State law and not the Federal Rules or federal evidence rules, would not be protected in a Federal action. Id.

27. 95th Cong., 2nd Sess. 5 (1978), reprinted in "A Legislative History of the Clean Air Act Amendments of 1977", at pp. 4400 and 4093. The provisions confirm citizens' ability to bring suit to enforce Clean Air Act requirements, an ability drawn into question by some previous court decisions.

28. United States v. Nixon, 418 U.S. 683, 710 (1974).

29. For example, with respect to the attorney-client privilege, if a court finds certain communications were made for the purpose of committing a future criminal act, the communications will no longer be protected. The client's purpose in seeking legal counsel is controlling. See, United States v. Calvert, 523 F.2d 895 (8th Cir. 1975), cert. den. 424 U.S. 911 (1975). With respect to the work product rule, disclosure of information that would ordinarily be protected may be required if the attorney's work product is created to cover up some wrongdoing. See, In re John Doe Corporation, 675 F.2d 482, 492 (2d. Cir. 1982) ("The work product itself may be part of a

criminal scheme and all reason for protecting it from judicial exmination evaporates.")

30. For a comprehensive review see, United States v. Louisville and Nashville R.R., 236 U.S. 318 (1914) . And see, J.W. Gergacz, Attorney-Corporate Client Privilege, 37 Busi. L. 461 (Jan. 1982).

31. Philadelphia v. Westinghouse Electric Corp., 210 F. Supp. 483 (E.D. Pa. 1962).

32. Diversified Industries, Inc. v. Meredith, 572 F.2d 596 (8th Cir. 1978), see also, Harper & Row v. Decker, 423 F.2d 487 (7th Cir. 1970) aff'd 400 U.S. 348 (1971).

33. 449 U.S. 383, at 386 (1981).

34. Id., at 391.

35. Id., at 392.

36. See, In re John Doe Corporation, 675 F.2d 482 (2d Cir. 1982) (where a company prepared a report for both internal and external purposes, attorney-corporate-client privilege was lost).

37. To prevent breaches of confidence, employees or third party consultants with access to sensitive data might also be required to sign an "agreement of confidentiality."

38. Id., at 492 (1982).

39. Gardner, Agency Problems in the Law of Attorney-Client Privilege: Privilege and "Work Product" Under Open Discovery, 42 U. Det. L. J. 105, 134 (1964).

40. Fed. R. Civ. P. 26(b)(3).

41. See, Thomas Organ Co. v. Jadranska Slobodna Plovidba, 54 F.R.D. 367 (N.D. Ill. 1972).

42. Id., at 372.

43. Almaguer v. Chicago, Rock Island & Pacific Railroad Co., 55 F.R.D. 147, 149 (D. Neb. 1972).

44. 8 Wright & Miller, Federal Practice and Procedure: Civil §2024, pp. 198 (1970). Unfortunately, this allows courts some flexibility in deciding the issue and therefore has led to conflicting results. See, In re Grand Jury Investigation, 599 F.2d 1224 (3rd Cir. 1979). But see, Diversified Industries Inc. v. Meredith, 572 F.2d 596 (8th Cir. 1977).

45. Transmirra Prods. Corp. v. Monsanto Chem. Co., 26 F.R.D. 572, 579 (1960). Although the work product rule expressly limits discovery to "documents and tangible things," oral communications are protected as well.

46. Hickman v. Taylor, 329 U.S. 495, 551 (1947).

47. Fed. R. Civ. P. 26(b)(3).

48. In re Grand Jury Investigation, 599 F.2d 1224, 1231 (3rd. Cir. 1979).

49. In re Grand Jury Investigation (Sturgis), 412 F. Supp. 943, 949 (E.D. Pa. 1976).

50. In re Grand Jury Investigation, 599 F.2d 1224, 1233 (1979).

51. Id, at 1232-33 (showing of "good cause" is required).

52. Fed. R. Civ. P. 26(b)(3).

53. Bunting v. Gainsville Mach. Co., 53 F.R.D. 594 (D.C. Del. 1971).

54. United States. v. International Business Machines Corp., 415 F. Supp. 668 (1976).

55. Fed. R. Civ. P. 26(b)(3).

56. 8 Wright & Miller, Federal Practice and Procedure: Civil §2024, pp. 210 (1970).

57. In re John Doe Corporation, 675 F.2d 482, 489 (2d. Cir. 1982).

58. In somewhat similar circumstances--though it was the government claiming the privilege--the court in rejecting the work product claim stated that, "to argue that every audit is potentially the subject of litigation is to go too far." Coastal States Gas Corp. v. Department of Energy, 617 F.2d 854 (D.C. Cir. 1980). In the circumstances of that case, the court suggested the work product rule will prevent disclosure only after a "specific charge or allegation [is] under investigation." Id., at 865.

59. The privilege is known by various names, including privilege against disclosure of self-evaluative documents, privilege of self-critical analysis, and self-evaluative report privilege.

60. See, Neb. Rev. Stat. §71-2048 (1981); Wis. Stat. Ann. §146.38 (West Supp. 1982).

61. 50 F.R.D. 249 (D.D.C. 1970), aff'd, 479 F.2d 920 (D.C. Cir. 1973).

62. Id., at 250.

63. See, Note, "The Privilege of Self-Critical Analysis," 96 Harv. L. Rev. 1083 (1983)(discussing these three criteria in a review of the development of the self-evaluative privilege).

64. See, Webb v. Westinghouse Elec. Corp., 81 F.R.D. 431, 434 (E.D. Pa. 1978).

65. 50 F.R.D. 249, at 251.

66. 1 Wigmore on Evidence §283 (3rd ed. 1940).

67. Comment by Frank Friedman, Vice-President, Health and the Environment, Occidental Petroleum Company, EPA Environmental Auditing Opinion Leaders' Workshop (June 9, 1983).